

Finance Committee Memorandum

City of Arts & Innovation

TO: FINANCE COMMITTEE MEMBERS **DATE: SEPTEMBER 25, 2017**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: ANNUAL FINANCIAL REVIEW OF THE CITY'S LIABILITY INSURANCE TRUST FUNDS - FISCAL YEAR 2016-2017

ISSUE:

Receive an annual financial review of the City's Liability Insurance Trust Funds.

RECOMMENDATION:

That the Finance Committee receive, provide input on and forward to the City Council an annual review of the financial position of the City's Liability Insurance Trust Funds ("LITF").

BACKGROUND:

Last year, City staff began presenting to the City Council, through the Finance Committee, financial and operational review of the City's liability funds, including claim activity. This review includes the Workers' Compensation and General Liability Funds.

The Human Resources Department administers the City's Workers' Compensation program. The Risk Management Division of the Finance Department, through a third party administrator, has responsibility for the General Liability program on behalf of the City.

The City carries insurance coverage to mitigate the most significant losses it may incur. For General Liability losses, the City carries commercial liability insurance in the amount of \$20,000,000 for general and auto liability claims, with a self-insured retention of \$3,000,000 per occurrence. This means the City covers out of funds on hand, the costs of any claim up to the first \$3,000,000 incurred. After that, the insurance policy covers the next \$20,000,000. If a claim exceeded the combined total of \$23,000,000, then the City would again be responsible for costs out of its own funds.

The situation is identical for the Worker's Compensation program, except that the insurance coverage has a policy limit of \$25,000,000. There have been no claims settled in the last ten years that exceed insurance coverage under either program. Each year as the insurance policy is renewed, the existing structure with a \$3.0 million self-insured retention is re-evaluated to determine if a more beneficial (less risk exposure) option exists. This specific structure has been the best option for many years.

All City departments participate in the Risk Management program and make payments to the LITF based on actuarial estimates of the amounts needed to fund prior and current year claims and incidents that have occurred but have not reported.

DISCUSSION:

A. Financial Overview

Historically, the two largest cash outlays in the liability trust funds are claim payments and outside legal fees. While claim payments are driven by many factors, outside legal expense is a byproduct of claims in process and initiated during the year. For FY 2016-17, outside legal fees for the Worker's Compensation and General Liability funds were approximately \$496,000 and \$1,475,000 per year, respectively.

As of June 30, 2017, unaudited outside legal fees are projected to be \$100,000 under budget for the Worker's Compensation Fund and to be on budget for the General Liability fund. This is primarily the result of continued efforts by the City Attorney's Office to assign more claims litigation work to in-house staff rather than to outside legal counsel.

Self Insurance Trust Funds Analysis

Fund Activity (Thousands)	Audited Data				Unaudited	Projected	
	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Beginning Fund Balance	\$(14,575)	\$(21,856)	\$(27,135)	\$(27,779)	\$(31,954)	\$(30,291)	\$(31,973)
Charges for Services-WC	4,376	4,228	6,000	6,126	6,022	6,187	6,750
Charges for Services-GL	7,420	7,424	7,400	7,494	7,470	7,644	8,250
Interest Income-WC	183	146	139	179	50	87	115
Other Income-GL	-	-	-	4	-	3	5
Total Revenue	11,979	11,799	13,539	13,804	13,542	13,922	15,120
Direct Personnel-WC	481	511	551	428	560	534	561
Direct Personnel-GL	0	0	0	0	0	463 ¹	486
Prof.Serv & Other Non-Personnel-WC	96	95	287	109	139	223	234
Prof.Serv & Other Non-Personnel-GL	178	199	180	926	217	293	307
Indirect Charges-WC	251	261	187	166	193	440 ³	462
Indirect Charges-GL	521	529	315	439	1,148 ²	941	988
Claims & Judgments-WC	3,423	4,027	3,477	4,003	3,899	3,750	3,800
Claims & Judgments-GL	5,766	3,030	2,363	4,314	2,218	4,500	2,500
Legal Fees-WC	428	518	404	435	496	299	284
Legal Fees-GL	3,073	2,280	1,859	1,178	1,475	1,300	1,250
Premiums-WC	372	390	424	487	447	436	458
Premiums-GL	400	409	439	445	476	498	523
Actuarial Adjustment-WC	4,545	1,674	1,109	3,680	2,081	1,750	1,750
Actuarial Adjustment-GL	(514)	1,932	2,554	835	(360)	1,000	750
Misc. Expense-WC	167	205	9	217	12	29	200
Misc. Expense-GL	75	67	27	315	27	50	75
Total Expense	19,260	16,127	14,183	17,978	11,879	15,604	14,629
Ending Fund Balance	\$(21,856)	\$(26,184)	\$(27,779)	\$(31,954)	\$(30,291)	\$(31,973)	\$(31,482)
Cash Position	\$9,977	\$9,023	\$11,611	\$12,746	\$14,357	\$15,622	\$21,163
Measure Z Contribution						\$2,500	\$2,500
Projected Cash Position						\$18,122	\$23,663
Estimated Claims & Judgments	\$31,235	\$34,841	\$38,505	\$43,020	\$44,741	\$47,491	\$49,991
Cash Balance as a % of Total Liability	32%	26%	30%	30%	32%	38%	47%

¹ Increase relates to the transfer of risk management personnel to the liability fund as part of insourcing the claims administration process.

² Increase relates to an increase in utilization charges from the General Fund for City Attorney staff time.

³ Increase relates to the insourcing of the claims administration process and related ongoing charges for a new claims software system.

B. Cash Position and Fund Balance

Total **cash** on hand between both funds is currently approximately \$14.3 million, representing an increase of \$1.6 million from the prior year. The reason for the increase is primarily the result of a decrease in claim payments made from the general liability trust fund. Total claims payments decreased approximately \$2.2 million and was offset by minor increase in other areas.

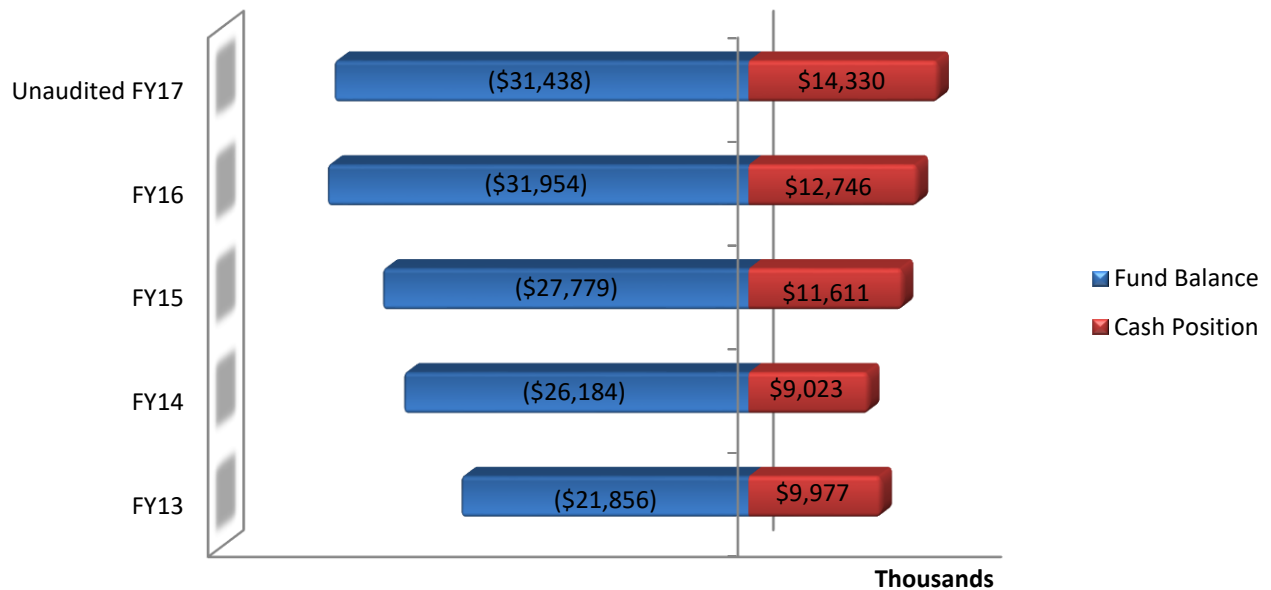
The **fund balance** is negative and reflects the long term nature of many of the claims – in other words, there is not enough cash on hand now to cover all potential claims and liability payouts expected in future years. Currently, there is sufficient cash on hand to cover 32% of the long-term liabilities. This coverage ratio is projected to increase to 47% over the next two fiscal years based

on increasing charges for services to the various city departments and contributions from Measure Z.

It is generally not good practice to keep cash on hand to cover 100% of anticipated future liabilities. Staff is developing a policy to recommend to the Finance Committee as to what an appropriate level of funding should be. Staff has been looking at cities across the country to determine the “best practices” in this regard. To date, few cities have been found that have any formal policy as to what level of funding is targeted for this type of liability. One example is San Diego, where the policy requires a 50% funding level for the liability funds. The policy is anticipated to be brought forward to the Finance Committee in October 2017.

Even though the cash position in the Liability Funds has improved, claims are rather volatile and unpredictable. The Finance Department will continue to address overall fund balance through increases in internal charges for services with the intent of bringing the cash position of the Funds to a reasonable ratio with a long term goal to meet or exceeded forthcoming policy recommendations.

Cash Position and Fund Balance



C. Claims Liability

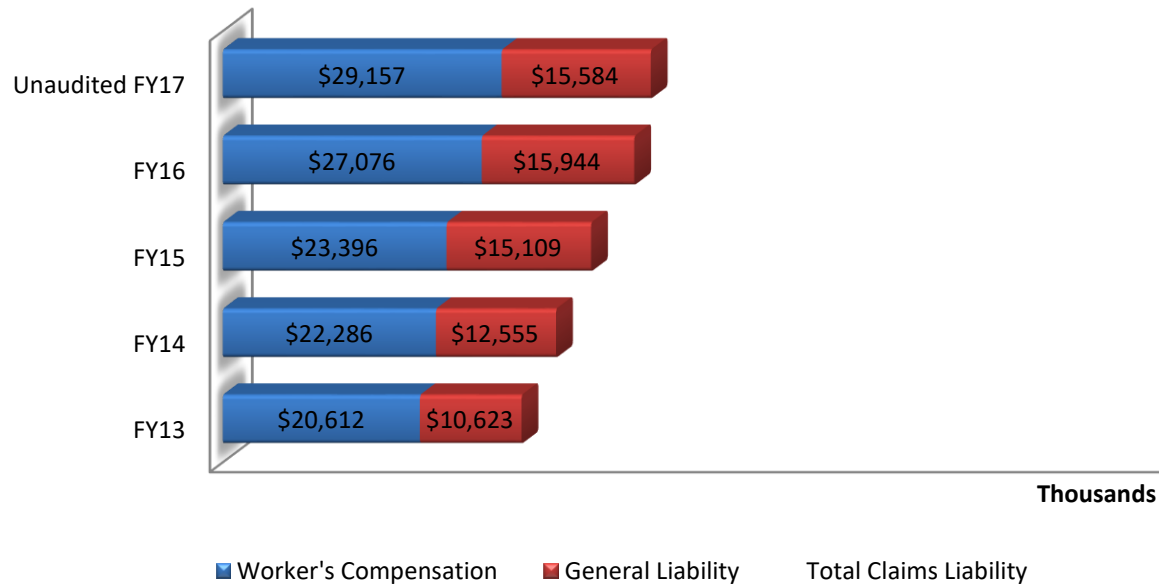
It is important to recognize that the claims liability amount recorded in each fund is an estimate of the amount for which that claim will ultimately be settled. These claims are often resolved for less than the total amount reflected in the claims liability figure, and that full amount of cash is not required to service the total claims liability. Additionally, in both funds, but particularly with Workers' Compensation, the actual outlay of cash is many years away (as many as 30 or more) for much of the outstanding liability.

Being self-insured requires valuing the City's claims liability for incurred claims losses and maintaining appropriate reserve funds to meet these future liabilities. In accordance with accounting standards, the City engages an actuarial consultant to perform a complex analysis of claims for both the Worker's Compensation and General Liability fund, the result of which is the determination of the total claims liability for each fund at the end of each fiscal year. The recorded estimate for total claims liability is based on the result of this study and includes an estimate for

claims incurred but not reported and for allocated loss adjustment expenses. The actuary's estimated liability considers the effect of inflation, recent claim settlement trends, frequency and amount of payouts, and other economic and social factors.

Following is a historical look at the trend of claims and judgment liability for the General Liability and Worker's Compensation fund.

Claims and Judgment Liability By Fund



The trend for the total claims liability, as determined by the actuary, has been increasing for several years. Despite cash outflows being volatile from year to year, the annually increasing liability creates an even greater negative fund balance. Increasing the internal charge for services has a positive impact on cash position of the trust funds, but puts additional pressure on operating budgets throughout the City.

FISCAL IMPACT:

There is no direct fiscal impact associated with this report; however, the liability funds are currently inadequately funded. Increasing the funding will have impact on the General Fund, which is anticipated to be discussed at the time the reserve policy is presented to the Finance Committee in the next couple months.

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Attachment: Presentation